UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
Alexandria Division

In re:	)	
	)	
THE BENTLEY FUNDING GROUP, LLC	)	Case No. 00-13386
	)	Chapter 11 (Involuntary)
Debtor	)	

MEMORANDUM OPINION

Before the court is the motion filed by AXA Global Risks United States Insurance Company ("AXA") on November 20, 2000, for allowance of an administrative claim. A hearing was held in open court on December 5, 2000, at which the debtor, AXA, and creditor SK&R Group, LLC, were represented by counsel. The United States Trustee was not present. At the conclusion of the hearing, the court took the matter under advisement to review the applicable law. For the reasons stated, the motion will be denied.

Facts

The facts are undisputed. The Bentley Funding Group, LLC, ("the debtor" or "Bentley") is a Virginia limited liability company that was formed to purchase and develop an approximately 170-acre tract of land in the Woodbridge area of Prince William County, Virginia, which is part of a mixed-use development known as River Oaks. On August 8, 2000, an involuntary chapter 11 petition was filed against the debtor by five insider creditors and an order for relief was entered on September 6, 2000. The debtor remains in possession of its estate as debtor in possession.

As a requirement for subdivision approval, Bentley was required to enter into an agreement with Prince William County ("the County") dated March 10, 1998, under which Bentley undertook to construct and install all of the physical improvements and facilities within 12 months. This agreement was secured by five performance bonds dated March 10, 1998, in the aggregate amount of $2,615,332.00 executed by Bentley as principal and AXA as surety. Before executing the bonds, AXA had entered into an indemnity agreement dated March 5, 2000, with Bentley, under which Bentley agreed to exonerate and indemnify AXA for any losses it might suffer under the suretyship arrangement. Although Bentley commenced development work on River Oaks, it ran out of money before the work could be completed. On April 20, 2000, the County declared Bentley in default with respect to two of the bonds totaling $2,079,539.00 and made demand on AXA to pay that amount to the County or perform the work itself. A similar demand was made on June 6, 2000, when the County declared a default on two additional bonds totaling $523,893.00. AXA then undertook to complete the public improvements at its own expense. It was stipulated at the hearing that AXA had expended $866,479.00 post-petition in "hard costs" to perform Bentley's obligations and that such expenditures have benefitted the debtor's estate. It is for these expenses that AXA seeks approval and payment of an administrative claim.

Issue Presented

Whether AXA's post-petition performance of the debtor's pre-petition bonding obligations to the County should be characterized as an administrative expense under 11 U.S.C. § 503(b)(1)?

Discussion

11 U.S.C. § 503(b)(1)(A) states in relevant part:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title,[1] including—
>
> (1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.

In the present case AXA contends that it is entitled to an administrative expense under Section 503(b)(1)(A)[2] for post-petition expenditures incurred under its bonding agreement with the debtor because those expenditures stand independently from the bonding agreement itself. Specifically, AXA argues that under the indemnity agreement it holds a "bundle of rights" that it may exercise upon the debtor's default of that agreement. One of those rights, an indemnity right, allows AXA to sue for actual losses incurred each time AXA makes an expenditure under the bonds. Thus, AXA submits that when it made post-petition bond expenditures on behalf of the debtor, those expenditures were entitled to administrative expense treatment because AXA's indemnity rights with respect to such expenditures arose post-petition.

The costs and expenses of preserving an estate are not restricted to the specific categories specified in Section 503. *See In re Patch Graphics*, 58 B.R. 743, 745 (Bankr.

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[1] Section 502(f) claims are so-called "gap" claims in an involuntary case arising after the petition but before the entry of the order for relief. Such claims are treated as if they arose before the date of the filing of the petition. The court assumes for the purpose of the present ruling that none of AXA's claim relates to gap period expenditures.

[2] The advantages to a creditor of having an administrative expense claim rather than a general claim are primarily two-fold. First, in a reorganization, administrative expenses must be paid in full on the effective date of the plan, unless the holder of a particular claim has agreed to a different treatment. 11 U.S.C. § 1129(a)(9)(A). Second, in a liquidation, administrative claims have priority over other unsecured claims. 11 U.S.C. § 726(a)(1).

W.D. Wis. 1986). Rather, a request for priority payment of an administrative expense may qualify if: (a) the right to payment arose from a post-petition transaction with the debtor's estate; and (b) the consideration supporting the right to payment was beneficial to the estate of the debtor. *See In re Hemingway Transp., Inc.,* 954 F.2d 1, 5 (1st Cir. 1992). *See also Microsoft Corp. v. DAK Indus., Inc. (In re DAK Indus., Inc.)*, 66 F.3d 1091, 1094 (9th Cir. 1995); and *In re Molnar Bros.*, 200 B.R. 555, 559 & n.3 (Bankr. D. N.J. 1996). Here, the parties have stipulated that AXA's expenditures benefitted the estate. Therefore, the only issue for this court to decide is whether AXA's right to payment arose from a post-petition transaction with the debtor.

While it seems clear that while AXA's indemnification claim for the post-petition expenditures did not technically mature until after the debtor's bankruptcy petition was filed,[3] the claim had existed as a contingent claim since the date of the indemnification agreement's execution. Under the Bankruptcy Code, a "claim" is defined as a

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[3] See Va. Code Ann.§ 8.01-249(5) (claim for indemnity accrues for statute of limitations purposes "when the indemnitee has paid or discharged the obligation."). *See American Nat'l Bank of Portsmouth v. Ames*, 169 Va. 711, 748, 194 S.E. 784, 797 (1938), *cert. denied*, 304 U.S. 577, 58 S.Ct. 1046, 82 L.Ed. 1540 (1938); *City of Richmond v. Branch*, 205 Va. 424, 430, 137 S.E.2d 882, 886 (1964). Virginia recognizes two exceptions to this rule. If a contract, such as a policy of automobile liability insurance, evidences an undertaking to indemnify, not merely against *loss*, but against *liability* for a claim, the party entitled to indemnity may sue on the obligation (here the insurance policy) as soon as the amount of the claim is fixed and without first paying the judgment. *Indemnity Ins. Co. of North America v. Davis' Adm'r.*, 150 Va. 778, 143 S.E. 328 (1928). Additionally, where a party has by contract expressly agreed to *assume* a particular debt, the original obligor, after successfully being sued on the obligation, may bring a corresponding suit for indemnity without first paying the debt. *Linbrook Realty Corp. v. Rogers*, 158 Va. 181, 163 S.E. 346 (1932) (deed of trust assumed in connection with sale of real estate). In any event, it appears undisputed that AXA was able to obtain a prepetition judgment against the debtor in New Jersey for the entire penal amount of the defaulted bonds.

> (A) right to payment, *whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured,* disputed, undisputed, legal, equitable, secured, or unsecured; or
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> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, *whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured,* disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5)(emphasis added). Thus, a claim will be treated as a prepetition claim for bankruptcy purposes even though it is merely contingent or is unmatured under state law. *See In re Food Barn Stores, Inc.*, 175 B.R. 723, 728 (Bankr. W.D. Mo. 1994).

Nevertheless, AXA argues that it is entitled to an administrative expense in this case because "many post-petition expenditures have their genesis in pre-petition contractual documents and yet are accorded administrative status." *Memorandum in Support of Motion for Payment of an Administrative Expense*, at 3. However, as is obvious from a review of the cases considering this issue, the vast majority of courts have deemed claims of the type asserted by AXA to be pre-petition claims. As explained in *In re Highland Group, Inc.*, 136 B.R. 475 (Bankr. N.D. Ohio 1992), "[w]here an indemnification agreement is entered into prior to a bankruptcy filing, such an execution gives the indemnitee a contingent pre-petition claim. This is so even where the conduct giving rise to the indemnification occurs post-petition." *Id.* at 481; *see also In re Remington Rand Corp.*, 836 F.2d 825 (3rd Cir. 1988) ("an indemnity or surety agreement creates a right to payment, albeit contingent, between the contracting parties immediately upon the signing of the agreement"); *In re Chateaugay Corp.*, 102 B.R. 335 (Bankr. S.D.N.Y. 1989) (indemnity loss claims pursuant to an agreement entered into and

executed prior to the filing date are clearly pre-petition claims); and *In re THC Financial Corp.*, 686 F.2d 799 (9th Cir. 1982).

AXA's reliance *on In re Mid-American Waste Systems, Inc.*, 228 B.R. 816 (Bankr. D. Del. 1999) and *In re Heck's Properties, Inc.*, 151 B.R. 739 (S.D. W. Va. 1992) in support of its position is misplaced.[4] In *Mid-American*, the court found that *because no post-petition transaction had occurred*, no administrative expense could be allowed. 228 B.R. at 821. Thus, *Mid-American* fails to support AXA's contention that its post-petition expenditures should be afforded administrative expense treatment. Additionally, *Heck's Properties* involves a very different factual scenario. In that case, corporate officers and directors – the majority of whom had been hired post-petition – had been required to defend a post-petition state court lawsuit by the Equity Security Holder's Committee alleging breach of fiduciary duty in causing the debtor to propose a chapter 11 plan "which would financially devastate Heck's shareholders, while providing a windfall to senior management …" 151 B.R. at 767. The Court, while noting that "[n]umerous courts have denied administrative expense priority under § 503(b)(1)(A) to corporate officials seeking indemnification under the provisions of corporate by-laws when it is determined that the acts or services which gave rise to the claims occurred before rather than after the filing of the petition for relief in bankruptcy," 151 B.R. at 766, ruled that the indemnity claims of the officers and directors (under indemnity provisions in the

[4] AXA also cites to an unpublished opinion, *First Indemnity of America v. Kemenash*, No. A-734-98T2 (N.J. Super. Ct. App. Div. Feb. 10, 2000). However, as AXA itself recognizes, *Kemenash* involves a non-bankruptcy setting in which a state court examined legal rights which might be barred by the statute of limitations, not rights associated with 11 U.S.C. § 503(b)(1)(A).

debtor's prepetition articles of incorporation) for the costs of successfully defending the suit were entitled to administrative priority because the alleged improper conduct occurred post-petition. Thus, *Heck's Properties* is clearly distinguishable from the present case, since the conduct triggering AXA's indemnication claim – Bentley's failure to complete the subdivision improvements within the 12-month period specified in the subdivision agreement with the County – occurred several months prepetition.

The present case, it must be stressed, is not one in which a party, having entered into an executory contract with a debtor prior to bankruptcy, continues to perform or to provide a benefit after the bankruptcy is filed. Post-petition performance under an executory contract raises entirely different issues from those presented here.[5] Here, not only the indemnity agreement but the default occurred pre-petition. Once the County declared a default, AXA's liability on the bond became fixed. Had AXA desired to do so, it could have simply paid the County the amount of the bond. Instead it chose to mitigate its losses by coming in and performing the work the debtor was obligated to perform. While that performance unquestionably benefits the debtor by enhancing the value of the River Oaks project, AXA's obligation to do something – to pay the bond or alternatively to minimize its losses by performing the work itself – arose prepetition. That the amount of its loss was not fully determined on the filing date, and that its indemnity agreement with the debtor did not restrict it to a single action but allowed it to bring multiple actions as it made expenditures, does not

[5] Indeed, one of the cases cited by AXA in its memorandum, *In re Beverage Canners Intl. Corp.,* 255 B.R. 89 (Bankr. S.D. Fla. 2000), involves an executory license agreement for use of a trademark and is readily distinguishable from the present case on that basis.

make its losses any less of a prepetition "claim" as that term is broadly defined in 11 U.S.C. § 101(5).

Conclusion

For the reasons stated above, a separate order will be entered denying the motion to accord administrative expense status to AXA's post-petition expenditures.

Date: January 2, 2001

Alexandria, Virginia

/s/ Stephen S. Mitchell
Stephen S. Mitchell
United States Bankruptcy Judge

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